Ind-Ra Affirms Fullerton India at 'IND AA+'; Outlook Stable

Ind-Ra-Mumbai-1 December 2014: India Ratings & Research (Ind-Ra) has affirmed Fullerton India Credit Company Limited's (FICCL) Long-Term Issuer Rating at 'IND AA+'. The Outlook is Stable. Ind-Ra has also affirmed FICCL's Short-Term Issuer Rating at 'IND A1+'. A full list of ratings is at the end of this commentary.

KEY RATING DRIVERS

The ratings reflect Ind-Ra's expectation of continued support from FICCL's parent Fullerton Financial Holdings (FFH), a subsidiary of Temasek Holdings Ltd - a sovereign wealth fund of the government of Singapore which is highly rated globally. FFH is the 100% owner of FICCL, and has regularly injected common equity into FICCL. It also actively monitors FICCL's liquidity, risk, operations and management through its strong representation on FICCL's board. The Stable Outlook reflects Ind-Ra's assessment of continuation of the existing level of support from FFH to FICCL.

FICCL's standalone operating metrics have seen a multipronged improvement in FY14 (year end March) due to the company's focus on increasing secured products in its product portfolio (% of AUM FY14: 42%; FY13: 36%). Its robust credit underwriting process, built around risk analytics incorporating credit bureau data, has also started yielding results. Consequently, credit costs have continued their downward trajectory (credit costs to average managed assets FY14: 2.6%; FY13: 2.8%). Also, FICCL's prudent provisioning policy of 90-day NPL recognition has made it compliant with new non-banking financial company (NBFC) norms without any impact unlike most of its peers. Additionally, FICCL maintains conservative standard asset provision of 50bp against the peer median of 27bp. FICCL also writes-off NPLs on unsecured loans after 120 days overdue, which is conservative.

FICCL's pre-provisioning operating profit to credit cost buffer at 2.3x for FY14 (from 1x in FY11) coincides with its 'AA+' category peer NBFC median after adjusting for the impact of new norms. However, the key differentiator in FICCL's approach to risk assessment is its use of a product lifetime loss estimation tool called recession loss multiplier (RLM). Besides driving near-term improvement in opex ratios through channelised resources, the use of RLM is likely to reduce credit cost volatility in the medium term. As FICCL expands into relatively newer product categories such as loan against property and rural loans (contributed 70% and 33% to incremental AUM from March 2013 to June 2014, respectively), offsetting the runoff in its unsecured loan portfolio, its ability to maintain credit buffers would be a key monitorable.

FICCL's funding has continued its transition from short-term commercial papers and borrowings to long-term bank lines and non-convertible debentures (long tenure funding mix in FY14: 85%, FY13: 73%, FY11: 33%), which has helped it attain a well-matched ALM profile across tenors. The company has also consistently diversified its investor base to reduce funding concentration risk and currently has 85 institutional lenders compared to 35 in FY12. Also, FICCL has over INR10bn unused committed bank lines for its contingent liquidity needs and a policy for keeping two months of outflow as cash buffers, which further supports its short-term ratings. FICCL's market borrowings now track closer to 'AA+' median curve compared with12-18 months earlier.

While the previous improvement in FICCL's operating cost came from headcount rationalisation and process centralisation, the current uptick in opex ratios have been driven by productivity focus aided by analytics., Increasing scale of operations and implementing systems which compress turnaround time from on boarding to disbursement have helped operating cost to managed asset ratio to improve consistently (FY14: 8.9%; FY13: 11.5%) despite a 13% yoy rise in manpower in FY14. Consequently, FICCL has managed to maintain its return on average assets (RoA) at 2.93% in FY14 (FY13: 2.99%) despite the sacrifice on yields from the increased proportion of secured products and the cost of having a better-matched ALM book. However, Ind-Ra believes FICCL will need to demonstrate a consistent improvement in operating and credit costs over the medium term to offset the steady decline in net interest margins from its shift to secured loans and the impact of income tax kicking in FY16 onwards.

Since the last equity injection by its parent in September 2012, FICCL has managed its asset growth

through healthy internal accruals. With a medium term (FY15-FY20) loan growth target of 27%, Ind-Ra expects Tier 1 ratio (FYE14: 19%) to be sufficient for addressing growth requirements while parent support remains, if required.

RATING SENSITIVITIES

FICCL's ratings are support driven. Ind-Ra believes the current trend of sustained improvement in FICCL's financial and operational performance could increase support expectations from the parent and could lead to the rating Outlook being revised to Positive.

However, if support from FFH declines in Ind-Ra's assessment along with a drop in operating and capital buffers, FICCL's ratings could be downgraded.

Rating actions on FICCL are as follows:
- Long-Term Issuer Rating: affirmed at 'IND AA+'; Outlook Stable
- Short-Term Issuer Rating: affirmed at 'IND A1+'
- INR2bn secured, redeemable non-convertible debenture (increased from INR1.25bn): affirmed at 'IND AA+'
- INR3.5bn subordinated lower Tier 2 bonds (increased from INR2bn): affirmed at 'IND AA+'
- INR2.5bn short-term debt: affirmed at 'IND A1+'

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